# No. 15,174

IN THE

# United States Court of Appeals

## For the Ninth Circuit

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AMERICAN PIPE & STEEL CORPORATION,
*Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

## PETITIONER'S OPENING BRIEF.

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### STATEMENT OF JURISDICTION.

Petitioner American Pipe & Steel Corporation is a Nevada corporation organized in 1929 with its principal place of business in Alhambra, California (Tr. p. 51*). Petitioner's consolidated tax returns for the taxable years 1944, 1945 and 1946 were filed with the Collector of Internal Revenue for the Sixth District of California at Los Angeles (Tr. p. 52).

Respondent Commissioner determined deficiencies in income and excess profits taxes due from petitioner

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*The statements set forth in the findings of the Tax Court, and appearing at pages 50-53 of the transcript, are based upon the stipulation of facts entered into by the parties and filed with the Tax Court (Tr. p. 115).

for the years 1944, 1945 and 1946, as follows (Tr. p. 50):

| Year | Deficiency in Income Taxes | Deficiency in Excess Profits Taxes |
|---|---|---|
| 1944 | $23,504.02 | $34,955.02 |
| 1945 | 17,753.50 | 84,299.14 |
| 1946 | 53,264.70 | |

Pursuant to Section 272 of the Internal Revenue Code of 1939, petitioner duly filed its petition for redetermination of the deficiencies with The Tax Court of the United States, being Docket No. 28539 (Tr. pp. 7-43), respondent filed its answer (Tr. pp. 43-46), and the case was tried upon a stipulation of facts and oral and documentary evidence.

The Tax Court entered findings of fact and its opinion (Tr. pp. 49-79) and, on February 28, 1956, entered its decision whereby it ordered and decided that there were deficiencies in petitioner's income tax and excess profits taxes for the years in question in the amounts determined by respondent (Tr. p. 80).

Within three months thereafter, and on May 22, 1956, petitioner filed its petition for review of the decision of the Tax Court pursuant to Sections 7482 and 7483 of the Internal Revenue Code of 1954 (Tr. pp. 647-651). These two sections are believed to sustain the jurisdiction of this Court.

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## NATURE OF THE CONTROVERSY.

By stipulation, the sole issue presented to the Tax Court was whether petitioner was entitled to the tax

benefits which it claimed in its consolidated tax returns for the years 1944, 1945 and 1946 by reason of petitioner's acquisition and ownership of the entire capital stock of Palos Verdes Estates, Inc., a California corporation (Stipulation of Facts, paragraph 16).

Respondent Commissioner determined that, on or about December 2, 1943, petitioner acquired all of the capital stock of Palos Verdes Estates, Inc. (hereinafter referred to as Palos Verdes), for the principal purpose of avoiding Federal income and excess profits taxes by securing the benefit of deductions, credits or other allowances of Palos Verdes which would otherwise not be enjoyed by petitioner, within the meaning of Section 129 of the Internal Revenue Code of 1939, as amended (Tr. pp. 30-31).

Respondent further determined that the privilege of filing consolidated income and excess profits tax returns for the years in question, including therein the operations of petitioner and Palos Verdes, was not within the intent or purview of Section 141 of the said Code (Tr. p. 31).

The Tax Court upheld the respondent's determination.

The Court's findings of fact, however, consist simply of a rambling recital of portions of the evidence; no conclusionary or ultimate facts were found (Tr. pp. 51-75). The opinion of the Tax Court is equally obscure. No evidence was reviewed in the opinion, no reasons were advanced for the decision,

and the opinion does not reveal any basis for upholding respondent's determination (Tr. pp. 75-79).

It is apparent that the Tax Court relied wholly upon the presumption of correctness of respondent's determination (Tr. pp. 75, 79) and, in such reliance, the Court erred. Petitioner having established at least a prima facie case in support of its position, the presumption ceased and, therefore, could not furnish any basis for the decision (*Hemphill Schools, Inc. v. Commissioner* (1943, 9th Cir.), 137 F.2d 961, 964).

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**STATUTES INVOLVED.**

Section 129 of the Internal Revenue Code of 1939 was added by an Act of February 25, 1944, and was made applicable to taxable years beginning after December 31, 1943 (58 Stat. 47-48). It provided, in part, as follows:

> "(a) *Disallowance of deduction, credit, or allowance.* If (1) any person or persons acquire, on or after October 8, 1940, directly or indirectly, control of a corporation, or (2) any corporation acquires, on or after October 8, 1940, directly or indirectly, property of another corporation . . . and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income or excess profits tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For the purposes of clauses (1) and (2), control means the owner-

ship of stock possessing at least 50 per centum of the total combined voting power of all classes of stock entitled to vote or at least 50 per centum of the total value of shares of all classes of stock of the corporation . . . ."

Section 141 of the Code provided, in part, as follows:

"(a) *Privilege to file consolidated returns.* An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making consolidated income and excess-profits-tax returns for the taxable year in lieu of separate returns . . .

"(d) *Definition of 'affiliated group.'* As used in this section, an 'affiliated group' means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if—

"(1) Stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the non-voting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

"(2) The common parent corporation owns directly stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the non-voting stock of at least one of the other includible corporations. . . ."

## STATEMENT OF THE CASE.

Petitioner sustained its burden of proving the allegations of its petition by establishing that legitimate business purposes, and not tax avoidance or evasion, motivated its acquisition of the capital stock of Palos Verdes Estates, Inc.

Petitioner proved this in the Tax Court by showing an absolute lack of motive for acquiring a "tax-loss" corporation; that is, (a) by showing that it acquired Palos Verdes through appropriate and regular corporate action for business purposes; (b) by establishing that it did thereafter use Palos Verdes as a profitable subsidiary; and (c) by proving, through the future development of the Palos Verdes area, that petitioner used good business judgment in acquiring Palos Verdes.

This showing was not met or controverted by respondent.

In view of the case established by petitioner, the presumption in favor of respondent's ruling had no probative force as evidence to offset or rebut petitioner's case. When the presumption vanished from the case, respondent thereupon had the burden of meeting petitioner's evidence. Having failed to do so, there is no evidence to support the Tax Court's decision; the decision should have been in favor of petitioner.

The facts proved by petitioner are as follows:

### A. PETITIONER ESTABLISHED THAT LEGITIMATE BUSINESS PURPOSES MOTIVATED ITS ACQUISITION OF PALOS VERDES.

It was proved, without contradiction, that proper business purposes were the only forces motivating petitioner's acquisition of the capital stock of Palos Verdes. The evidence was as follows:

#### 1. Petitioner's business purposes in acquiring Palos Verdes were set forth in its corporate action duly taken.

The reasons why petitioner acquired the stock of Palos Verdes were expressed at length in its president's letter of November 25, 1943, to the board of directors of petitioner and such reasons were restated in his uncontradicted testimony at the trial (Ex. 20; Tr. pp. 391-396).

Petitioner's president, Mr. Lane, had been a licensed real estate broker since 1936 (Tr. p. 352), he had considerable experience in handling and managing properties and leases, and in subdivision projects (Tr. pp. 328-329, 342, 351-352), and he was familiar with the Palos Verdes project (Tr. pp. 329-332).

The letter of November 25th commenced as follows:

> "Last May, Robert P. Archer wrote us regarding the Palos Verdes Estates, Inc. and a copy of that letter is attached hereto. Of course, at that time we were not interested in his proposition, but during the interim I have occasionally discussed his situation with him and have followed the activities of the company.
>
> "Archer's original plan was to acquire controlling interest in the company in order to elect

a new Board of Directors, which would seek to rehabilitate the company in the real estate business. The present Board of Directors, however, attempted this rehabilitation by making the stock assessable and wanted the stockholders to put up sufficient money to pay the taxes and proceed with the development and/or sale of its properties. The plan failed and Archer does not have the funds to proceed with his original plans, therefore, he has informally proposed that we pay him his costs for his interest in the company and in such event he will seek to acquire the rest of the outstanding stock. This would give us Palos Verdes as a wholly owned subsidiary for approximately $13,000.00.

"In the exhaustive study which I have made, I find that the lots owned by the company come under three classifications:

(1) Represents approximately 147 lots in the Lunada Bay Area. All lots in this are contiguous.

(2) Represents approximately 315 lots located in the uppermost part of the tract and covers about 115 acres. All lots in this area are contiguous.

(3) Represents approximately 235 to 250 lots scattered throughout the tract.

"There are approximately 11,000 lots originally subdivided in the subdivision owned by Palos Verdes Estates, Inc. There is only one real estate broker doing business at the present time in the City of Palos Verdes, which leaves room for another live wire real estate company for post-war development.

"As you know, I have been a real estate broker for a number of years and am thoroughly familiar with the problems arising in the real estate business, as well as the profits to be gained.

"The American Pipe & Steel Corporation has many activities in which the control of a real estate company having powers broad enough to engage in other lines of business would be a distinct advantage. In this connection, I will list below several of these advantages which we have discussed informally many times. . . ."

Thereupon, the letter listed the advantages to petitioner of acquiring Palos Verdes, as follows:

*Water pipe and casing business.*

"(1) In connection with our water pipe and casing business, we have often lost large sales when competitors had an 'in' with the developer of a subdivision or could have taken property as part payment for the pipe and well casing.

"If the development and sale of the Palos Verdes properties and other real estate put into the company, we could tie the sale of pipe and casing in with the sale of the property.

"When subdivision developers (as we have seen in the past) are under-financed, we could buy part of the property as our security, and after supplying the pipe and well casing, could realize our profit as the subdivision was sold."

*Oil well equipment business.*

"(2) In connection with our oil well equipment business, we have often seen competitors take leases and also purchase real property outright, thereby being in a position to tie in the

sale of their oil field equipment with the leasing of the properties to the oil companies. This is quite an old procedure in California and Texas, and if we owned Palos Verdes, oil properties could be taken by them for leases or sub-leases to oil companies who would use American Pipe's products."

*Sale of steel houses.*

"(3) For post war, Celotex Corporation has approached us informally on the matter of handling the sale and erection of steel houses which have been designed by the Pierce Foundation in cooperation with the Republic Steel Corporation and the Celotex Corporation. If we had the Palos Verdes Estates, Inc. or some subsidiary real estate company, it would provide a controlled outlet for fostering the development of sales of steel houses. Whether or not we make a deal with Celotex or others, I believe that the steel houses will be a very lucrative post-war item, and the American Pipe should be interested in the fabrication and erection of these houses in one way or another."

*Sale of liquefied gas containers.*

"(4) In connection with the manufacture of propane and other liquefied gas containers, we have seen various distributors in the east, and particularly Ernest Fannin in Arizona, build very lucrative businesses by loaning storage equipment to consumers and thereby controlling the sale of their liquefied gas. This, as you know, enables the liquefied gas distributor to charge from 1¢ to 3¢ a gallon more for his product than is charged by distributors having uncontrolled

outlets and when the consumer owns his own storage equipment.

"You are also familiar with the fact that we have often considered informally starting the distribution of liquefied gases to enhance the value of containers. If we were to acquire Palos Verdes, a number of the lots could be set aside for development and containers would be furnished the purchasers of houses in the area, and Palos Verdes could distribute liquefied gas instead of running gas lines to the areas which do not have gas lines. This particular area would be a very good one in which to start the distribution of liquefied gases because there are approximately 20,000 acres undeveloped in which natural gas lines have not yet been laid. During the next 10 or 15 years a good part of this property is likely to be developed and built up.

"Inasmuch, as we would want to start in the distribution business in a small way, one of the areas now in Palos Verdes Estates, Inc. presents an ideal place to start with a very small initial investment."

The letter concluded with the following proposals:

*Proposal for acquisition and use of Palos Verdes.*

"I, therefore, propose that the American Pipe & Steel Corporation purchase the Palos Verdes Estates, Inc. for the purpose of handling all of American Pipe's activities outside of the actual fabrication of steel products. I propose that a Board of Directors be elected which has the experience and ability to engage the company in the real estate business and any other profitable

activities which will directly or indirectly benefit the American Pipe & Steel Corporation."

*Proposal for sale of Palos Verdes lots.*

"I would propose to this Board that the Area No. 3 be sold at public auction, over and above taxes, to raise sufficient funds to pay off the taxes on the other two areas, and that if sufficient money were not raised in this method, that one of the other areas also be sold. However, the contiguous lots should be sold at a private sale rather than at auction. This would leave the company with less property, but it would be free and clear of taxes which would enable Palos Verdes to be a factor in the real estate business in Southern California."

*Proposal for sale to Palos Verdes of rejected containers.*

"I would also propose that American Pipe (in the event that they acquire Palos Verdes) sell to Palos Verdes all of the rejected containers from the Chemical Warfare Contract at a price above what we have been offered by the junk dealers.

"This would enable Palos Verdes to enter into the distribution of L.P. Gas."

A meeting of petitioner's Board of Directors was held the following day, November 26, 1943, to consider Lane's letter and proposal (Tr. pp. 460-461). At the meeting Lane discussed the proposal at length, whereupon a resolution was adopted authorizing Lane, as president of petitioner, to acquire all stock of Palos Verdes Estates, Inc. (Ex. 36).

**2. On the same day Palos Verdes was acquired, petitioner's president worked out a program for the profitable sale of lots.**

On December 2, 1943 (the day that petitioner acquired the stock of Palos Verdes), Lane received from Haggott, the then president of Palos Verdes, a typewritten tabulation or inventory of the property owned by Palos Verdes, showing, among other things, the total taxes on the lots (Ex. 24; Tr. pp. 408-409). At the same time Haggott also sent a list of the lots, showing lot, block and tract numbers and zone classifications (Ex. 26; Tr. pp. 411-412). The tabulation and list were both attached to a note from Haggott to Lane, which pointed out how future real property taxes on the lots might be reduced (Ex. 25; Tr. p. 409).

On the same day (December 2, 1943), Lane made handwritten computations on the tabulation for the benefit of his "partner," Kreiger, and wrote a note to Kreiger on the top of the paper, as follows (Ex. 24; Tr. p. 410): "12/2/43 Woody—Note & return (This is how we are figuring the profit on the lots)."

Lane's handwritten computations indicated that the value of the lots on an acreage basis was about $1,000 per acre on approximately 300 acres, and that lots should bring about $1,500 each on a building program where streets and utilities were in (about 100 lots) and about $750 each where streets and utilities were not in (about 580 lots) (Ex. 24; Tr. pp. 416-417). Figuring sales of the 100 lots at $1,500, sales of 500 lots at $750, and sales of 80 lots at only $400, Lane calculated gross sales at $550,000 (Ex. 24; Tr. pp. 417-418).

From the gross sales, Lane calculated deductions of $97,406 for property taxes due, $5,700 for assessments of the Palos Verdes Home Association, approximately $22,000 for property taxes for the next two or three years, and $75,000 for the sales expenses; after making these deductions, Lane wrote that $350,000 "should clear" (Ex. 24; "Recap"; Tr. p. 418). Lane also noted, "Our Cost approx $12,000" (Ex. 24; Tr. p. 418).

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**B. THE EVIDENCE ESTABLISHED THAT, UPON ACQUISITION OF PALOS VERDES, PETITIONER UTILIZED IT AS A PROFITABLE SUBSIDIARY.**

Petitioner's use of Palos Verdes as an effective and profitable subsidiary, in substantial conformity with petitioner's plans at the time of acquisition, was shown by the following evidence:

**1. Petitioner almost immediately realized a profit of 33% on its investment by sales of Palos Verdes lots.**

Palos Verdes sold some of its lots at a public auction sale in January, 1944, about six weeks after petitioner acquired its subsidiary (Tr. p. 452). On these sales, petitioner realized a net profit of 33% ($16,185—Tr. p. 481) on its total cost of acquisition of Palos Verdes ($11,850—Ex. BB).

The program outlined in the November 25th letter, for sale of the lots over a long period of time, was frustrated because of the terms of an interlocutory decree entered in a Superior Court action in Los Angeles County, which prevented payment of delinquent

taxes against the lots over a five-year period as planned by petitioner (Tr. pp. 453, 491). At the time of acquisition, petitioner did not know that the interlocutory decree prevented these long-term amortization payments (Tr. pp. 405-406, 453). Petitioner's president naturally assumed that the same payment privileges attached to the property tax assessments under the decree as would have been in effect if the taxes had been wholly valid, but the County Assessor ruled otherwise (Tr. pp. 453, 491).

The testimony of Mr. Lane in this respect was not contradicted, although three potential sources of proof were available to respondent had he intended to dispute the fact. These sources were Mr. Archer (who caused tax suit to be commenced), Mr. Haggott (the president of Palos Verdes at the time the suit was filed), and the attorney who represented Palos Verdes in the suit. Archer testified as petitioner's witness and Haggott was called by respondent, but neither witness disputed Mr. Lane's testimony (Tr. pp. 204-205, 258-259, 585-596). The attorney did not testify.

**2. Petitioner caused Palos Verdes to replace its lots with other properties calculated to afford petitioner the same outlet for its products and for expansion of its activities.**

As shown, the November 25th letter of Mr. Lane to petitioner's board of directors outlined a comprehensive program for the use of Palos Verdes as a subsidiary for the expanded development of, and as an additional outlet for, petitioner's products. Among other things, the petitioner's president proposed (Ex. 20):

> ". . . that the American Pipe & Steel Corporation purchase the Palos Verdes Estates, Inc. for the purpose of handling all of American Pipe's activities outside of the actual fabrication of steel products. I propose that a Board of Directors be elected which has the experience and ability to engage the company in the real estate business and any other profitable activities which will directly or indirectly benefit the American Pipe & Steel Corporation."

Petitioner's business purposes in acquiring Palos Verdes were demonstrated by the fact that petitioner actually carried out the proposal of its president. Although the original Palos Verdes lots were either sold or were lost under the tax decree, Palos Verdes Estates, Inc., as petitioner's subsidiary, did acquire considerable other property which was utilized to further petitioner's business (Tr. pp. 451, 464-468).

The Tax Court recognized that petitioner's subsequent use of Palos Verdes was corroborative of petitioner's purpose in acquiring the subsidiary. Thus, the record shows the following occurred during the presentation of this evidence (Tr. pp. 465-466):

> "Mr. Chase: If the Court please, I am going to object . . . . What materiality does the question along this line have?
>
> "Mr. Baird: Well, it has great materiality because part of our case is to show that Palos Verdes Estates, Inc., was not acquired merely as a subterfuge for taxes. We are endeavoring to show the facts here that this was a legitimate genuine business enterprise in 1943 and that the use of it, *the use of the company since that time, corroborates that view.*

"The Court: *That is the way I understand it. If you are objecting, the objection is overruled.*"

Notwithstanding the Court's observation at the time, in reaching its decision the Tax Court completely ignored these facts. Petitioner's subsequent utilization of Palos Verdes in these respects was not given the slightest mention in the "Findings of Fact" (Tr. pp. 49-75). The conclusion of the Tax Court was expressly made, "On the basis of the foregoing facts" (Tr. p. 75); that is, upon those facts, and those facts only, which were set forth in the findings.

The uncontradicted testimony of Mr. Lane, as to Palos Verdes' acquisition and operation of additional properties in furtherance of petitioner's business, was as follows (Tr. pp. 450-451):

"Q. . . . You testified yesterday that your main objective or at least one of your main objectives in acquiring Palos Verdes Estates, Inc. was because it had tremendous potential value for real estate purposes. Now, I will ask you whether or not you were able to develop the Palos Verdes Estates, Inc. for real estate purposes after you acquired the stock?

"A. That was the main plan that we had to develop it, to develop the sales of the lots of Palos Verdes Estates and add other . . . real estate properties to it. This has already been testified to that some of the lots were sold and some lots were lost under a tax decree . . . But during the period that I was connected with Palos Verdes Estates, Inc. we did add considerable properties to it. Palos Verdes Estates did buy some houses."

And further (Tr. pp. 464-468):

"A. In line with the real estate business they bought four acres in Bakersfield and rented that. . . .

"A. . . . They purchased or leased the land . . . [on which] Palos Verdes built . . . a bulk gasoline station. . . .

"Q. . . . Now, Mr. Lane, referring to the bulk stations about which you are now testifying, will you tell us when you installed those bulk stations?

"A . . . I believe it was in 1944. . . .

"Q. Now, did you own these bulk plants?

"A. Palos Verdes built two and they leased them. I believe it was leased on an eight or nine-year basis . . . It was a business investment of Palos Verdes and it also brought American Pipe and Steel Corporation the tank business that was involved. The one station at Firebaugh was built at a cost of about . . . $29,000 . . .

"Q. Did you have a bulk plant at San Diego?

"A. Yes, there was one built at San Diego. . . .

"Q. And when was that?

"A. About the same time that Firebaugh, a little bit after. It was either 1944 or 1945 . . .

"Q. And did Palos Verdes operate that plant?

"A. No, they leased that plant; it was also one that was built for investment.

"Q. Can you state whether or not these operations have been profitable to Palos Verdes?

"A. Yes, they were."

As stated, this evidence was not mentioned in the findings of fact and the Tax Court expressly based

its conclusion upon only such facts as were set forth in the findings (Tr. p. 75), notwithstanding the fact that the evidence was not disputed and the Court recognized its materiality.

**3. In furtherance of petitioner's plans for expansion of its oil-well equipment business, Palos Verdes acquired profitable oil leases.**

One of the plans advanced in Lane's letter of November 25th was stated as follows (Ex. 20):

> "(2) In connection with our oil well equipment business, we have often seen competitors take leases and also purchase real property outright, thereby being in a position to tie in the sale of their oil field equipment with the leasing of the properties to the oil companies. This is quite an old procedure in California and Texas, and if we owned Palos Verdes, oil properties could be taken by them for leases or sub-leases to oil companies who would use American Pipe's products."

The evidence shows that petitioner also carried out this program (Tr. pp. 462-464). Again, however, this evidence was not mentioned in the Tax Court's findings (Tr. pp. 49-75), although the evidence was without dispute and the Court recognized its materiality (Tr. p. 466).

The testimony ignored by the Court was as follows (Tr. pp. 462-464):

> "Q. Now, also, one of the reasons that has been stated is that you could use it to some advantage in connection with your oil well equipment business. Now, in what respects would that be an advantage to you?

"A. . . . We would take the leases on structures that we were familiar with and then lease or sublease those leases to friendly oil companies who would use our equipment. In some instances, we have had opportunities to buy land before the companies got into there to do the leasing and that ran up the price in many instances. In those instances, we, when we would obtain the land, we would be the landowner and we would lease to the other company.

". . . Palos Verdes did take over a lease . . . called the Cat Canyon lease . . . and Palos Verdes leased one-half interest to Fletcher Oil Company and they went in as a joint venture on the other half interest.

"The first well on that property came in for several hundred barrels a day . . .

"Q. Was that profitable for Palos Verdes Estates?

"A. Very."

Mr. Lane also testified that Palos Verdes took other oil leases (Tr. p. 477).

**4. Palos Verdes also leased and operated an oil refinery in order to effectuate petitioner's plans for expansion of its oil equipment business.**

In furtherance of petitioner's purpose of acquiring and using a profitable subsidiary, Palos Verdes leased an oil refinery in Bakersfield, California, in December, 1943, or January, 1944, and thereafter it profitably operated the refinery (Tr. p. 476). The purpose of this operation was both to make money and to prove out some new equipment developed by petitioner (Tr. p. 464).

As the Tax Court itself recognized (Tr. p. 466), these facts further demonstrated that petitioner's acquisition of Palos Verdes was motivated by sound business reasons. Nevertheless, the Tax Court failed to give any consideration to such facts in arriving at its decision (Tr. pp. 49-75).

The testimony of petitioner showed that (Tr. p. 464):

> "The refinery . . . was leased . . . for the purpose of making money in the first place and the second was to prove out some, well, they are what we call bubble caps. In a refinery, you have towers that are part of the refining process and inside of the towers is what we call bubble caps. Our engineers had figured out a type of bubble cap and heat exchanger, used with a heat exchanger produced by National Tank Company, and it was something that we wanted to explore the value of. So we had a two-fold purpose. One was to prove up the equipment and the other was to make money in the first place. And that was a profitable venture, too."

This testimony was not attacked by respondent.

**5. In addition, petitioner's oil equipment business was promoted by Palos Verdes' acquisition of a boat for charter to oil companies engaged in geological work off the Coast.**

The Tax Court's findings of fact also ignore the following testimony of Mr. Lane (Tr. pp. 468-469):

> "Q. Now, will you tell us what other line of endeavor did Palos Verdes engage in?
>
> "A. Palos Verdes invested in a boat for charter work to oil companies.

"Q. . . . what kind of boat was it?

"A. It was a mine sweep and was purchased from the United States Government . . .

"A. . . . At the time that boat was purchased a number of oil companies were doing geophysical work off the coast of Southern California in anticipation of the United States Department of the Interior leasing offshore lands . . ."

This testimony was also undisputed. The Tax Court's failure to consider this testimony, however, is demonstrated by the fact that it expressly based its conclusion upon only the evidence stated in its findings of fact (Tr. p. 75).

**6. Acquisition of Palos Verdes provided a highly profitable outlet for disposal of Chemical Warfare containers when the original plan for their use could not be carried out.**

Petitioner had been one of the original developers of equipment for private liquefied gas systems, and that was a rapidly growing and very lucrative business (Ex. 34; Tr. p. 471). A number of gas distributors were customers of petitioner's equipment (Tr. p. 471). The gas distributors were making good profits and petitioner wanted to use Palos Verdes to get into the distributing end of the business without showing open competition with petitioner's own customers (Tr. p. 471).

When the Chemical Warfare Service contract was terminated, petitioner had 800 or 900 of the tank containers on hand (Tr. p. 472).

In his letter of November 25th to petitioner's board of directors, Mr. Lane stated (Ex. 20):

"You are also familiar with the fact that we have often considered informally starting the distribution of liquefied gases to enhance the volume of containers. If we were to acquire Palos Verdes, a number of the lots could be set aside for development and containers would be furnished the purchasers of houses in the area, and Palos Verdes could distribute liquefied gas instead of running gas lines to the areas which do not have gas lines. This particular area would be a very good one in which to start the distribution of liquefied gases because there are approximately 20,000 acres undeveloped in which natural gas lines have not yet been laid. During the next 10 or 15 years a good part of this property is likely to be developed and built up."

The letter proposed that petitioner (Ex. 20):

". . . sell to Palos Verdes all of the rejected containers from the Chemical Warfare Contract at a price above what we have been offered by the junk dealers.

"This would enable Palos Verdes to enter into the distribution of L. P. Gas."

Mr. Lane's judgment proved to be sound, as butane gas is being used in the Palos Verdes area (Tr. p. 558).

The tank containers were sold to Palos Verdes for $15,000 (Tr. p. 472), which was about double the cost to petitioner (Tr. p. 474). It developed, however, that the containers could not be used for the intended purpose, first, because they were to be used as a tie-in on a building deal to sell the lots and

that plan was frustrated by the tax suit decree and, second, because there was then an acute gas shortage in the area which prevented Palos Verdes from starting up in the distribution business (Tr. p. 473). Accordingly, the containers were converted into dredging pipe, propane tanks and chlorine tanks and were resold at a profit of from $80,000 to $125,000 (Tr. pp. 473-474).

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### C. EXPERIENCE HAS DEMONSTRATED THE GOOD FAITH AND SOUND JUDGMENT OF PETITIONER IN MAKING ITS DECISION TO ACQUIRE THE PALOS VERDES LOTS.

On December 2, 1943, the same date that Palos Verdes was acquired by petitioner, Mr. Lane worked out computations showing how a net profit of $350,000 could be made on the sale of the lots on a long-range development program. (Ex. 24; Tr. pp. 417-418).

Subsequent events have proved that these calculations were very conservative; that the profits to be made on such lots were simply fantastic.

In 1947, when the unredeemed lots were sold at the tax sale, Mr. Lane personally purchased as many of them as he could afford (Tr. p. 454); he bought about 197 lots (Tr. p. 455) and now owns almost 300 of them (Tr. p. 456). The lots were not reacquired by petitioner or Palos Verdes because the Government had made its income-tax audit and had then taken the position that petitioner could not have a subsidiary which was in the real estate business (Tr. pp. 457, 459).

Of the lots now owned by Lane, he has been offered $90,000 for 75 lots and $150,000 for the remainder; those are wholesale prices offered by responsible real estate builders who are already building in Palos Verdes (Tr. p. 456). The first offer amounts to about $1,200 per lot and the second one is about $800 a lot (Tr. p. 456). Lane did not accept the offers because they are too low (Tr. pp. 456-457).

Lane's testimony as to these values was not only undisputed, but it was fully substantiated by the testimony of Howard Towle. The latter is a real estate broker residing in Palos Verdes (Tr. p. 530). He started in the real estate business there in 1921 and has been familiar with the area ever since (Tr. p. 531).

In substance, Mr. Towle's testimony shows that lots in the Palos Verdes area were worth $1,200 to $2,250 by 1948 or 1949 (Tr. pp. 543-545). Some lots in that area are now valued at $3,500 (Tr. pp. 532, 546). A house purchased for $12,500 in 1942 was sold for $47,500 in 1950 and is now offered for sale for $65,000 (Tr. p. 550). In 1954, an undeveloped tract of 73 lots in the area was sold for $110,000 (Tr. pp. 551-552).

In overruling an objection while Mr. Towle was testifying, the Tax Court stated (Tr. p. 539):

> "In a matter involving value, subsequent facts can be introduced to show corroboration."

Notwithstanding its recognition of the materiality of this evidence, the Tax Court refused to give any consideration to it in reaching its conclusion. No mention was made of this evidence in the findings of fact

other than a brief statement to the effect that Mr. Lane bought lots at the 1947 tax sale (Tr. p. 65). And, as shown, the Court's conclusion was based solely upon the facts stated in the findings (Tr. p. 75).

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**D. PETITIONER ESTABLISHED THAT IT HAD NO MOTIVE WHATEVER FOR THE ACQUISITION OF PALOS VERDES AS A "TAX LOSS" CORPORATION, IN THAT PETITIONER HAD NO LARGE PAST, PRESENT OR PROSPECTIVE PROFITS OR HIGH-EARNING ASSETS.**

Petitioner's president testified without contradition that petitioner:

> ". . . was a small company. And . . . had a record of losing money for a number of years, back in 1929, ten or eleven or twelve years." (Tr. p. 338.)

Petitioner's earnings in 1940, 1941 and 1942 were small (Jt. Ex. 40-C; Tr. p. 482). Petitioner had no record of large earnings or high earnings assets and it had no reason to anticipate it would have large profits or high taxes in the future. Accordingly, there was no showing that petitioner needed a "tax loss" corporation to offset actual or prospective profits.

Petitioner acquired the capital stock of Palos Verdes Estates, Inc., on December 2, 1943 (Tr. pp. 164-165). As of that date, petitioner had the trivial total of $850 in Government prime ("war") contracts (Ex. 31).

The record further shows that petitioner had no prospects of receiving substantial war contracts in the

future. Other than the Chemical Warfare Service contract hereinafter mentioned, petitioner had never received any large war contract. The largest such contract awarded to petitioner in 1943 amounted to only $32,369.76 (Ex. 31). Petitioner did not receive any large contracts thereafter until May 12, 1944, when it was awarded a contract for $140,400 (Ex. 44).

Petitioner's commercial sales were likewise small. Its income tax return for the year 1943 showed a net profit of only $16,880.52 (Tr. p. 52).

In September, 1942 (one year and two months before it acquired Palos Verdes), petitioner was awarded a contract by the Chemical Warfare Service which amounted to approximately $3,500,000 (Tr. p. 484). However, this contract was terminated by the Government (for its convenience) on September 29, 1943 (Ex. 27; Tr. pp. 419-420). Thus, *the only substantial war contract which petitioner had ever obtained was cancelled over two months before petitioner acquired the stock of Palos Verdes.* The cancellation of this contract left petitioner with a backlog of but $850 in war contracts (Ex. 31).

It was demonstrated, therefore, that petitioner had no motive whatever for acquiring Palos Verdes as a "tax loss" device.

On the contrary, it was affirmatively shown, without conflict, that petitioner was motivated solely by legitimate business purposes in the acquisition of Palos Verdes. Petitioner's predominant motive for the acquisition, at a time when no substantial profits

were in view, was the long-range program outlined in the letter of petitioner's president, herein set forth (Ex. 20). And when it appeared that petitioner would sustain a loss of $350,000 to $600,000 by reason of the termination of the Chemical Warfare Contract (Tr. pp. 373-374), petitioner's president, Mr. Jack Lane, believed that a program could be undertaken with the real estate owned by Palos Verdes which would make a profit of $350,000, thus offsetting the anticipated loss from the contract cancellation (Ex. 24; Tr. p. 418).

Not only was this evidence uncontradicted, but respondent made no effort to dispute it.

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**SPECIFICATION OF ERRORS.**

It is respectfully submitted that the Tax Court erred:

1. In holding that there are deficiencies in income and excess profits taxes due from petitioner for the taxable years 1944, 1945, and 1946.

2. In holding that Section 129 of the Internal Revenue Code of 1939, as amended, is applicable under the evidence herein.

3. In holding that the petitioner was not entitled to file consolidated tax returns, and to secure the benefits of such returns, pursuant to Section 141 of the Internal Revenue Code of 1939.

4. In failing to find or determine that petitioner did not acquire the stock of Palos Verdes Estates,

Inc., for the principal purpose of evading or avoiding Federal income or excess profits taxes within the meaning of Section 129 of the Internal Revenue Code of 1939, as amended.

5. In failing to find or determine whether the acquisition of the stock of Palos Verdes Estates, Inc., by petitioner was or was not made for the principal purpose of evading or avoiding of Federal income or excess profits taxes by securing the benefit of a deduction, credit or other allowance which petitioner would not otherwise enjoy.

6. In failing to make any findings of fact with regard to petitioner's intent and purpose in acquiring the stock of Palos Verdes Estates, Inc.

7. In holding that the determination by the Commissioner as to petitioner's intent and purpose in acquiring said stock was entitled to be weighed and considered in determining the sufficiency of the evidence produced by petitioner on that issue.

8. In holding that the determination by the Commissioner relieved him of the duty to rebut or overcome the evidence produced by the petitioner.

9. In resting its holding and conclusion that petitioner had not sustained its burden of proof solely upon the determination of the Commissioner that petitioner's principal purpose in acquiring the stock of Palos Verdes Estates, Inc., was the evasion or avoidance of Federal income or excess profits taxes within the meaning of Section 129 of the Internal Revenue Code of 1939, as amended.

10. In that its findings of fact are not supported by substantial evidence or by the weight of the evidence, and are clearly erroneous.

11. In that its opinion and decision is contrary to law and the Regulations and is not supported by the evidence or by the findings of fact.

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**SUMMARY OF ARGUMENT.**

I. The Tax Court erroneously based its decision wholly upon an absent presumption in favor of respondent's determination.

A. The decision was expressly predicated upon the inapplicable presumption.

B. The Tax Court erred in relying upon the presumption.

C. The Tax Court failed to give any consideration to the merits of the case independently of respondent's determination.

II. The Tax Court erroneously failed to consider material and undisputed evidence comprising a substantial part of petitioner's case.

III. The findings of the Tax Court do not support its conclusion.

A. The Tax Court failed to find any ultimate facts which would sustain its conclusion.

B. The evidentiary findings made by the Tax Court sustain the contrary conclusion.

IV. The decision of the Tax Court is not supported by the evidence.

A. Petitioner affirmatively established that it did not acquire Palos Verdes for the principal purpose of avoiding taxes.

B. The presumption in favor of respondent's ruling has no probative force.

C. The Tax Court could not disregard petitioner's undisputed evidence.

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## ARGUMENT.

### I.

### THE TAX COURT ERRONEOUSLY BASED ITS DECISION WHOLLY UPON AN ABSENT PRESUMPTION IN FAVOR OF RESPONDENT'S DETERMINATION.

**A. The decision was expressly predicated upon the inapplicable presumption.**

Petitioner's case established that it did not acquire Palos Verdes for the principal purpose of evading or avoiding Federal income or excess profits taxes; hence, Section 129 of the Internal Revenue Code was inapplicable and petitioner was entitled to exercise its privilege of filing consolidated tax returns.

As has been shown, petitioner proved (a) that it acquired Palos Verdes for business purposes; (b) that petitioner thereupon used Palos Verdes as a profitable subsidiary in carrying out those business purposes; (c) that petitioner exercised sound business judgment in purchasing Palos Verdes; and (d) that

petitioner could not have been motivated principally or to any extent by tax considerations, as it had no high earning assets nor did it have any large past, present or prospective profits.

Other than reciting some of the evidence, the Tax Court failed to make any findings of its own with respect to any of these facts. Instead, the Court relied entirely on a presumption that respondent's determination was correct. Such reliance is shown by the language used by the Tax Court. After referring to some of the evidence, the Court concluded its "Findings of Fact" by stating (Tr. p. 75):

> "On the basis of the foregoing facts, we arrive at the ultimate conclusion that the evidence does not establish that respondent erred . . ."

The Court's complete reliance upon the Commissioner's determination was re-emphasized at the end of the "Opinion" portion of the decision (Tr. p. 79):

> "The Commissioner having determined that the tax benefit to be gained was the principal purpose behind the acquisition, it was petitioner's burden to prove that such determination was erroneous. After a careful study of the record made, we have concluded that petitioner has not successfully carried his burden of proof."

**B. The Tax Court erred in relying upon the presumption.**

The fundamental errors in the ruling of the Tax Court, quoted above, are as follows:

*First:* Petitioner's burden of overcoming the presumption in favor of respondent's determination was satisfied upon petitioner's introduction of substantial

evidence tending to prove that the determination was incorrect. Plainly, petitioner did produce such evidence and the Tax Court erred in concluding otherwise.

*Second:* Petitioner having produced substantial evidence contrary to respondent's determination, the presumption of its correctness had vanished, and the Tax Court erred in giving any consideration to that determination.

*Third:* The Court erroneously gave weight to a presumption which had no probative force.

*Fourth:* Petitioner having made out at least a prima facie case, it was the duty of the Tax Court to make its own findings and to reach its own conclusion on the evidence. In failing to do so, the Court erred.

It is true that there is a presumption of the correctness of the Commissioner's determination of a tax deficiency. But the presumption is a presumption of law affecting only the burden of proof. It is not an inference of fact. It has no probative force. The effect of the presumption is merely to require the taxpayer to present some substantial evidence contradicting it. When such evidence is introduced, the presumption disappears from the case. Otherwise stated, the taxpayer has caused the presumption to disappear when he has introduced evidence which would support a contrary finding.

The foregoing principles are established by many decisions. Thus, in *Crude Oil Corp.* v. *Commissioner* (1947, 10th Cir.), 161 F.2d 809, 810, it was said:

> "The presumption of the correctness of the Commissioner's finding is one of law. It is not an inference of fact. It disappears when evidence, sufficient to sustain a contrary finding, has been introduced."

In *J. M. Perry & Co.* v. *Commissioner* (1941, 9th Cir.), 120 F.2d 123, 124, this Court pointed out that the Commissioner's ruling:

> ". . . is presumptively correct, that is, until the taxpayer proceeds with competent and relevant evidence to support his position, the determination of the Commissioner stands. When such evidence has been adduced the issue depends wholly upon the evidence so adduced and the evidence to be adduced by the Commissioner. The Commissioner cannot rely upon his determination as evidence of its correctness either directly or as affecting the burden of proof."

This concept was similarly stated in *Belyea's Estate* v. *Commissioner* (1953, 3rd Cir.), 206 F.2d 262, 265-266:

> "Of course, the presumption of the correctness of the Commissioner's ruling which imposes this burden of proof on the challenging taxpayer has no probative force as evidence to offset or rebut the taxpayer's proof."

The ruling of the Tax Court herein was almost identical to the following finding of the Board of Tax Appeals in *Hemphill Schools, Inc.,* v. *Commissioner* (1943, 9th Cir.), 137 F.2d 961, 963:

> "The evidence does not overcome the determination of respondent that petitioner was

availed of for the purpose of preventing the imposition of surtax upon its shareholders by permitting gains and profits to accumulate beyond the reasonable needs of the business instead of being distributed. Accordingly, we sustain the respondent."

Upon the principles stated above, this Court reversed the decision of the Board, pointing out that (137 F.2d at 964):

> "Evidence *was* produced. Some of the evidence produced by petitioner tended to prove that its gains and profits were not permitted to accumulate beyond the reasonable needs of its business. Evidence having been so produced, the presumption ceased, and thenceforth the issue depended 'wholly upon the evidence.' It thus became the duty of the Board to find from the evidence, and from it alone, whether petitioner's gains and profits were permitted to accumulate beyond the reasonable needs of its business. No such finding was made. Instead, the Board treated the presumption (which no longer existed) as if it were evidence, weighed it against petitioner's evidence and concluded that petitioner's evidence did not 'overcome' it."

Evidence *was* produced here also. Some of the evidence produced by petitioner at least tended to prove that it did not acquire Palos Verdes for the principal purpose of evading or avoiding income or excess profits taxes. Evidence having been so produced, the presumption ceased, and thenceforth the issue depended wholly upon the evidence. It thus became the duty of the Tax Court to find from the evidence,

and from it alone, whether petitioner's principal purpose in acquiring Palos Verdes was the evasion or avoidance of taxes. No such finding was made. Instead, the Tax Court treated the presumption (which no longer existed) as if it were evidence, weighed it against petitioner's evidence, and concluded that petitioner's evidence did not overcome it.

The great stress placed by the Tax Court upon respondent's determination is shown by its conclusion (Tr. p. 79):

> "The Commissioner having determined that the tax benefit to be gained was the principal purpose behind the acquisition, it was petitioner's burden to prove that such determination was erroneous. After a careful study of the record made, we have concluded that petitioner has not successfully carried his burden of proof."

By this conclusion, the Court erroneously ruled in effect that petitioner had failed to produce any substantial evidence in support of its position. This is true because, as shown, petitioner's burden of overcoming respondent's determination is satisfied upon the presentation of such substantial evidence. Therefore, the Tax Court's ruling here is no different than the following conclusions of law held erroneous in *Wiget* v. *Becker* (1936, 8th Cir.), 84 F.2d 706, 707:

> "1. That no substantial evidence has been introduced which will support a judgment for the plaintiff.
>
> "2. That plaintiff has failed to sustain the burden of proof resting upon her to establish

the illegality of the collection by the defendant of the tax sought to be recovered.

"3. That plaintiff has failed to overcome the prima facie case as established by the assessment duly made by the Commissioner of Internal Revenue."

As stated by the Court of Appeals in reversing the judgment entered on those conclusions of law:

"It is apparent from the conclusions of law entered by the lower court that great stress was placed upon the presumption of correctness of the determination by the Commissioner; . . . The presumption, however, is a rebuttable one, and will only support a finding in the absence of any substantial evidence to the contrary."

(*Wiget* v. *Becker, supra,* 84 F.2d at 707-708.)

**C. The Tax Court failed to give any consideration to the merits of the case independently of respondent's determination.**

Petitioner having proved at least a prima facie case, it became the duty of the Tax Court to find from the evidence, and from it alone, whether petitioner's principal purpose in acquiring the stock of Palos Verdes was the evasion or avoidance of income or excess profits taxes.

*Hemphill Schools, Inc.* v. *Commissioner, supra,* 137 F.2d 961, 964.

The Tax Court failed to make any findings on this issue. It did not find what the principal purpose of petitioner was in acquiring Palos Verdes. No findings at all were made as to any ultimate facts in the case.

The Tax Court's failure to consider the merits of the case, independently of respondent's determination, is shown by its disorganized recital of some of the evidence in its "Findings of Fact." No attempt was made to analyze such evidence or to consider its effect. Much of the evidence so recited has little, if any, relevance to the primary issues. Evidence which was of great importance to the case, on the other hand, was entirely omitted.

Thus, no mention was made in the findings of much of the evidence heretofore reviewed in the Statement of the Case, although the Tax Court recognized the significance and importance of such evidence at the time it was admitted (Tr. pp. 466, 549). The Tax Court failed to consider or mention the evidence that petitioner caused Palos Verdes to replace its lots with other properties calculated to afford petitioner with the same outlet for its products and for expansion of its activities. (Statement of the Case, point B 2, above). No consideration was given to the evidence that, in furtherance of petitioner's plans for expansion of its oil equipment business, Palos Verdes acquired profitable oil leases, leased or operated an oil refinery, and acquired and used a boat for charter work to oil companies (Statement of the Case, points B 3, 4 and 5). Neither did the Tax Court consider the established fact that subsequent events have demonstrated the sound nature of petitioner's business judgment in acquiring the Palos Verdes lots (Statement of the Case, point C, above).

The opinion of the Tax Court also shows that it did not undertake to fulfill its duty of independently determining the case on its merits. Unlike the situation in such cases as *Gillette's Estate* v. *Commissioner* (1950, 9th Cir.), 182 F.2d 1010, the Tax Court's opinion here does not contain any discussion, analysis or enumeration by the Court of any reasons or grounds for its decision. The evidence was neither reviewed nor analyzed. A few of the points established by petitioner's case were mentioned but were not determined (Tr. pp. 77-78). Instead, the decision is rested entirely upon respondent's determination of tax deficiencies (Tr. p. 79).

It is apparent that, in this instance, the Tax Court completely abdicated its duties and functions as a Court. In effect, its functions were delegated in full to the Commissioner. The presumption of the correctness of respondent's determination (a presumption of law relating solely to the burden of proof) was treated as if it had great probative force. The presumption, in fact, was given virtually conclusive effect.

The error of the Tax Court, in failing to give any independent consideration to the case, effectively deprived petitioner of its right to a trial by a court of law on the matters involved in the administrative determination of the Commissioner. It is respectfully submitted, therefore, that the decision of the Tax Court must be reversed.

## II.

### THE TAX COURT ERRONEOUSLY FAILED TO CONSIDER MATERIAL AND UNDISPUTED EVIDENCE COMPRISING A SUBSTANTIAL PART OF PETITIONER'S CASE.

The Statement of the Case herein (point B) sets forth at length the evidence showing that, upon acquisition of Palos Verdes, petitioner utilized it as a profitable subsidiary. Such evidence established the following points:

Petitioner caused Palos Verdes to replace its lots with other properties calculated to afford petitioner the same outlet for its products and for expansion of its activities (Statement of the Case, point B 2).

In furtherance of petitioner's plans for expansion of its oil-well equipment business, Palos Verdes acquired profitable oil leases (Statement of the Case, point B 3).

Palos Verdes also leased and operated an oil refinery in order to effectuate petitioner's plans for expansion of its oil equipment business (Statement of the Case, point B 4).

In addition, petitioner's oil equipment business was promoted by Palos Verdes' acquisition of a boat for charter to oil companies engaged in geological work off the Coast (Statement of the Case, point B 5).

Furthermore, subsequent experience has demonstrated the good faith and sound business judgment of petitioner in making its decision to acquire the Palos Verdes lots (Statement of the Case, point C).

The Tax Court expressly recognized the materiality of this evidence as corroborative of petitioner's business purposes in making the acquisition (Tr. pp. 466, 539), and the evidence was not contradicted. Nevertheless, in reaching its decision, the Tax Court wholly failed to give any consideration to these facts. The foregoing evidence was not mentioned in the "Findings of Fact" (Tr. pp. 49-75) and, in concluding this portion of its decision, the Tax Court stated (Tr. p. 75):

> "*On the basis of the foregoing facts,* we arrive at the ultimate conclusion that the evidence does not establish that respondent erred . . ." (Emphasis supplied.)

Thus, the Court's conclusion was expressly based upon only the "foregoing facts"; that is, upon only such evidence as was actually set forth in the "Findings of Fact."

It is demonstrated, therefore, that the Tax Court made its decision without any consideration of the undisputed evidence, reviewed above, constituting a substantial part of petitioner's case. The evidence ignored will not admit of the determination made by the Commissioner. It is the evidence in which the presumption of the correctness of the Commissioner's determination dissolves. It is the evidence which, together with the facts acknowledged by the Tax Court, proves the purpose of the petitioner in its acquisition of Palos Verdes.

Under these circumstances, it is respectfully submitted that the decision must be reversed.

## III.

### THE FINDINGS OF THE TAX COURT DO NOT SUPPORT ITS CONCLUSION.

The decision of the Tax Court, in substance, was that petitioner had failed to produce any substantial evidence tending to overcome respondent's determination of tax deficiencies (Tr. pp. 75, 79). But such decision does not find support even in the incomplete (and, therefore, misleading) findings of fact made by that Court for these reasons:

**A. The Tax Court failed to find any ultimate facts which would sustain its conclusion.**

As stated, the Tax Court's "Findings of Fact" consist simply of a recital of some evidence. No ultimate or conclusionary facts were found. No findings were made which would lead to, or provide support for, the decision of the Tax Court.

It was not found that petitioner's principal purpose in acquiring the stock of Palos Verdes was the evasion or avoidance of income or excess profits taxes. Indeed, no ultimate finding at all was made relative to any purpose, principal or otherwise, of petitioner in acquiring Palos Verdes. The Tax Court did not make any conclusionary findings of fact as to the business purposes expressed by petitioner for this acquisition or as to the business purposes for which petitioner utilized its subsidiary. The Court did not even mention most of the uncontradicted evidence of petitioner as to the means by which it used Palos Verdes to carry out petitioner's business purposes.

**B. The evidentiary findings made by the Tax Court sustain the contrary conclusion.**

Such material evidence as was actually mentioned in the "Findings of Fact" does not lead to the Tax Court's decision, but sustains the contrary conclusion; that is, that petitioner did *not* acquire Palos Verdes for the principal purpose of evading or avoiding income or excess profits taxes.

Thus, the findings contain a recital of the November 25th letter of petitioner's president and the action of petitioner's board of directors thereon, pursuant to which petitioner acquired the Palos Verdes stock (Tr. pp. 67-73). Such evidence demonstrates that legitimate business purposes motivated petitioner's acquisition of Palos Verdes by proper corporate action duly taken (Statement of the Case, point A, above). Yet the Tax Court did not find that petitioner's purposes were not as set forth in such corporate action.

The evidentiary findings also show the following (Tr. pp. 66-67, 74-75):

That petitioner's Chemical Warfare Service contract was terminated by the Government more than two months prior to the acquisition of Palos Verdes; that petitioner had invested large amounts in preparing to perform and in performing that contract; that it had assigned its accounts receivable to the bank to secure a huge loan necessitated by the contract; that petitioner, therefore, was without operating funds; that petitioner was then facing a tremendous loss as a result of the termination of the

contract; that the negotiations with the Government finally resulted in a loss of $116,240.30 to petitioner due to the contract termination; that petitioner's total backlog of war contracts in December, 1943 was only $850; and that petitioner did not receive any substantial war contracts thereafter until on or about July 15, 1944, some eight months after Palos Verdes was acquired.

Again such evidence does not lead to or sustain the decision reached by the Tax Court. To the contrary, the evidence shows that petitioner could not have been motivated by tax considerations because it did not have any high-earning assets or large past, present or prospective profits.

Other evidentiary findings, although incomplete, similarly fail to sustain the Court's conclusion.

The findings state, for example, that the tank containers were disposed of by Palos Verdes at a large profit (Tr. p. 74), although no direct mention is made of the reasons why the original plan for use of such containers could not be carried out (Tr. p. 473).

While the Tax Court found that Palos Verdes made no improvements on its properties (Tr. p. 73), the findings elsewhere show why that was not done. As the Court found (Tr. pp. 64-65), most of the lots were sold and the balance were lost under the tax suit decree. It was also noted in the findings that petitioner's accounts receivable had been assigned to the bank to secure the loan necessitated by the Chemical Warfare contract, that said contract had been termi-

nated, and that petitioner was without funds to pay off the property taxes (Tr. pp. 66-67).

In addition, Mr. Lane testified that, at the time of the acquisition of Palos Verdes, he did not know of the special provisions of the interlocutory decree in the tax suit limiting the period of redemption; it was this peculiar feature of the decree which frustrated his plan to pay the property taxes over a period of years (Tr. pp. 405-406, 453, 491). As has been shown, such testimony was not contradicted. No contrary finding was made by the Tax Court.

Upon such evidentiary findings as were actually made by the Tax Court, therefore, its decision is without support, and this is true even though such findings failed to consider or mention most of the material and undisputed evidence establishing petitioner's profitable utilization of Palos Verdes as a subsidiary to further petitioner's business interests.

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## IV.

### THE DECISION OF THE TAX COURT IS NOT SUPPORTED BY THE EVIDENCE.

**A. Petitioner affirmatively established that it did not acquire Palos Verdes for the principal purpose of avoiding taxes.**

Not only was it shown that petitioner had no motive, purpose or reason for acquiring a "tax loss" corporation, as such, but petitioner affirmatively proved that it was prompted solely by sound business reasons in acquiring Palos Verdes (Statement of the Case, points A, B and C). Pursuant to the planned

program presented by its president in his November 25th letter, petitioner acquired Palos Verdes for the purpose of utilizing it as an effective and profitable subsidiary to further the business interests of petitioner, and the subsidiary was actually so used. The good business judgment exercised by petitioner in making such acquisition has been proved by the subsequent developments in the Palos Verdes area (Statement of the Case, point C, above).

Under such circumstances, petitioner was entitled to exercise its privilege of filing consolidated tax returns under §141 of the Internal Revenue Code, and §129 thereof was inapplicable. Section 129 disallows a tax benefit to the acquiring corporation only when "the principal purpose for which such acquisition was made is evasion or avoidance of Federal income or excess profits tax . . ." That section has no application where, as here, the acquisition or reorganization was undertaken wholly or predominantly for legitimate business purposes.

*Chelsea Products, Inc.* (1951), 16 T.C. 840 (affirmed (3rd Cir.) 197 F. 2d 620);

*Alcorn Wholesale Co.* (1951), 16 T.C. 75;

*Berland's Inc. of South Bend* (1951), 16 T.C. 182;

*J. E. Dilworth Co. v. Henslee* (1951, M.D. Tenn.), 98 F. Supp. 957.

Even in cases where the acquisition or reorganization was expressly motivated, in part, by tax reasons, it has been recognized that §129 is inapplicable, the tax motives not being predominant.

*Alcorn Wholesale Co.,* supra, 16 T.C. 75, 89;
*Berland's Inc. of South Bend,* supra, 16 T.C. 182, 188.

Petitioner herein had neither motive nor reason for seeking means of reducing income or excess profits taxes, and it did not do so. As has been shown (Statement of the Case, point D, above), when Palos Verdes was acquired on December 2, 1943, petitioner was a small company without any history or prospects of large profits or high earning assets. Its sole war contract of any substance had been cancelled some two months previously. With the cancellation of that contract, petitioner was faced with a huge loss. Its total backlog of prime contracts on the date of acquisition amounted to only $850.

Nothing in petitioner's past, present or foreseeable future presented any particular problem with respect to income or excess profits taxes. To the contrary, petitioner's problem was to find means of earning profits and not to avoid taxes.

Petitioner's situation and acquisition did not come within the purpose, objective or intent of §129 of the Internal Revenue Code. In fact, petitioner's financial picture presented just the converse of the situation contemplated by that section.

The objective of §129, as shown by the committee reports, was to prevent the distortion through tax avoidance of the deduction, credit or allowance provisions of the Internal Revenue Code, *particularly those of the type represented by the practice of cor-*

*porations with large excess profits* acquiring corporations with current, past or prospective losses or deductions, deficits or current or unused excess profits credits, for the purpose of reducing income and excess profits taxes.

*Commodores Point Terminal Corp.* (1948), 11 T.C. 411, 415-416.

The Treasury Regulations also recognize that §129 was directed at an acquisition or transfer by a corporation "with large profits" or "high earning assets." (26 C.F.R. 39.129-3 (b).)

Under the circumstances here, the Tax Court erred in upholding respondent's determination of tax deficiencies and in thereby applying §129 to this case and in failing to hold or determine that petitioner was entitled to exercise its privilege of filing consolidated tax returns pursuant to §141 of the Internal Revenue Code.

**B. The presumption in favor of respondent's ruling has no probative force.**

Petitioner having established at least a prima facie case showing (a) that it did not acquire Palos Verdes for the principal purpose of evading or avoiding taxes, and (b) that it did, in fact, make the acquisition for proper business purposes which were actually put into effect, the presumption of correctness of respondent's determination ceased to exist, "and thenceforth the issue depended 'wholly upon the evidence.' " (*Hemphill Schools, Inc. v. Commissioner,* supra, 137 F. 2d 961, 964.) When such evidence has been ad-

duced, "The Commissioner cannot rely upon his determination as evidence of its correctness either directly or as affecting the burden of proof." (*J. M. Perry & Co. v. Commissioner,* supra, 120 F. 2d 123, 124.) And, as stated in *Wiget v. Becker,* supra, 84 F. 2d 706, 707-708: "The presumption, however, is a rebuttable one, and will only support a finding in the absence of any substantial evidence to the contrary . . ."

It follows that the Tax Court's decision could not be rested, in whole or in part, upon respondent's determination. The Court was required to decide the case solely upon the evidence produced by petitioner and respondent.

**C. The Tax Court could not disregard petitioner's undisputed evidence.**

Respondent made no serious attempt to rebut the case established by petitioner, and he offered no competent evidence which tended to contradict that produced by petitioner on any material matter. The testimony of the four witnesses called by respondent was cursory only and did not tend to rebut any material fact proved by petitioner (Tr. pp. 571-575, 575-585, 585-596, 621-633).

It was shown without contradiction that petitioner's business purposes in acquiring Palos Verdes were as set forth in Mr. Lane's letter of November 25th and that petitioner actually utilized Palos Verdes to carry out those business purposes so far as possible. It was shown, further, that petitioner's inability to carry out

the program completely was due to the unusual provisions of the decree entered in the Palos Verdes tax suit, that such provisions were not known to petitioner at the time of the acquisition, and that petitioner did not have the funds to pay the property taxes in the short period of time available (Tr. pp. 405-406, 453, 491).

The business purposes of petitioner, therefore, were shown both by the direct and positive documentary evidence and also by the direct, positive and unimpeached testimony of petitioner's president. He was the man who best knew petitioner's purposes in making the acquisition and his testimony is consistent with every fact proved.

Under these circumstances, the Tax Court was required to accept petitioner's evidence. The situation here is the same as that involved in *Foran v. Commissioner* (1948, 5th Cir.), 165 F. 2d 705, 707, where it was said:

> "Here there is direct and positive evidence from the witness who best knows, that this property was for eighteen months held as an investment and not held for sale to customers. His testimony is consistent with every proven fact. He gives a credible reason why it was not for sale and why finally in 1941 he did sell it. We think the court's refusal to follow the sworn testimony is contrary to law, and requires the setting aside of its fact-finding as it would that of a jury."

The Tax Court, in this case, did not find that petitioner's purposes in acquiring Palos Verdes were any-

thing other than as shown by the corporate documents introduced in evidence and the testimony of petitioner's president. No ultimate facts were found in regard to such matters. Instead, the "Findings of Fact" merely recite some of this evidence and the decision is then based solely upon the respondent's prior determination. Accordingly, the comment of the Court of Appeals in *Wright-Bernet v. Commissioner* (1949, 6th Cir.), 172 F. 2d 343, 346, is equally pertinent here:

> "The Tax Court in its findings of fact adopted and reiterated the material evidence introduced by the petitioner, and then decided that the compensation of each employee for one year was unreasonable in the amount of $140, and for the second year in a greater amount. As the petitioner's witnesses were qualified and unimpeached, and no evidence was given to the contrary, their testimony should have been accepted."

The record in the present case is also similar to that involved in *Crude Oil Corp. v. Commissioner,* supra, 161 F. 2d 809, 810, where the issue was whether or not a certain tax return had been filed in time. The petitioner's evidence in that case indicated that a return addressed to the Collector had been timely mailed. Reversing the decision of the Tax Court, it was said:

> "The Tax Court did not find that the return was not filed within the statutory period. It merely held that the presumption of delivery was insufficient to overcome the presumption of correctness of the Commissioner's determination. We think the Tax Court fell into an error of law. The pre-

sumption of the correctness of the Commissioner's finding is one of law. It is not an inference of fact. It disappears when evidence, sufficient to sustain a contrary finding, has been introduced."

Since respondent offered no competent evidence herein tending to disprove the case made out by petitioner,

". . . the petitioner was denied the opportunity of examining the correctness of his computations; and was left to stand upon its own proof, none of which was refuted. Therefore, we think, the burden of presenting evidence to rebut any presumption in favor of the Commissioner's findings was fully met . . ."

(*R. P. Farnsworth & Co. v. Commissioner* (1953, 5th Cir.), 203 F. 2d 490, 492.)

The difficulty with respondent's position in this case is that it assumes the existence of a purpose which was not proved and which is contrary to both the documentary evidence and the uncontradicted testimony of petitioner's witnesses. In order to uphold respondent's position, such evidence must not only be regarded as wholly false, but it must also be held to prove *just the reverse.* As the Supreme Court commented in *U. S. v. American Bell Telephone Co.* (1896), 167 U.S. 224, 259:

"The difficulty with this charge of wrong is that it is not proved. It assumes the existence of a knowledge which no one had; of an intention which is not shown. It treats every written communication from the solicitor in charge of the application, calling for action, as a pretence, and

all the oral and urgent appeals for promptness as in fact mere invitation to delay. It not only rejects the testimony which is given, both oral and written, as false, but asks that it be held to prove just the reverse."

Moreover, although relying upon the respondent's determination, the Tax Court did not make any finding in accordance with respondent's position herein. The Court did not find that petitioner's purposes in acquiring Palos Verdes were anything other than as shown by petitioner's oral and documentary evidence.

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**CONCLUSION.**

We respectfully submit that the record in this case must be reviewed in the light of the fact that the Tax Court did not perform its function as a Court.

In this case the Tax Court did *not* weigh or evaluate the evidence, and it did *not* make any independent determination of the ultimate facts. The Tax Court, instead, rested its decision wholly upon respondent's determination. Consequently, any weight or regard which might otherwise be given the Tax Court's decision is not present here.

This is not a case, therefore, in which this Court is asked to review the evidence after the Tax Court has made its own review and determination. The case was never considered on the merits by the Tax Court. And if the Tax Court had considered the case on the merits, free of respondent's determination, it is ap-

parent that its decision must have been in favor of petitioner. Under the circumstances, it is respectfully submitted that the decision must be reversed.

Dated, San Francisco, California,
October 22, 1956.

Respectfully submitted,
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